

## Open Letter by Academics in Favor of Direct EV Sales and Service

April 14, 2021

We, the signatories of this letter, are active or emeritus professors employed at public or private universities in the United States. We specialize in economics, competition policy, market regulation, industrial organization, or other disciplines bearing on the questions presented in this letter. We come from across the political spectrum, and have a wide variety of views on regulation, environmental and consumer protection, and free enterprise as a general matter, but find common ground on the important issue of automotive direct sales.

We write to urge that any state laws still prohibiting car companies from selling their cars directly to consumers, or opening service centers for those vehicles, be amended to permit direct sales and service of electric vehicles (“EVs”).<sup>1</sup> While once there may have been valid dealer protection reasons for prohibiting direct distribution, those reasons are long gone. Prohibiting direct distribution of EVs is not supported by legitimate public policy objectives, and has a variety of negative consequences, including: (1) slowing the market penetration of EVs; (2) correspondingly, maintaining a higher share of internal combustion vehicles on the roads, with negative environmental consequences; (3) interfering with manufacturers’ freedom to experiment with new distribution models for new technologies and market conditions, thus reducing the competitiveness of the U.S. EV industry and advantaging foreign competitors; (4) interfering with consumers’ freedom to decide how they will purchase cars; and (5) interfering with free and functioning markets to privilege economic special interests.

For the past six or seven years, the direct sales issue has been associated primarily with Tesla’s efforts to enter the market, and its state-by-state battles with the car dealers’ lobby. Today, the right to sell directly remains vital to Tesla, but it is equally important to a new crop of American EV start-up companies including Rivian, Lordstown, Lucid, Bollinger, and others about to enter the market. It is also important to the legacy automobile companies like General Motors, Ford, and Chrysler, which should be allowed to compete with the start-ups on a level playing field. About half the states now permit at least some direct sales, although the particulars vary by state. We respectfully contend that all states should allow all car manufacturers to sell EVs directly to consumers, if they so choose.

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<sup>1</sup> We include in our definition of EVs any vehicle not powered by internal combustion, including fuel cell vehicles or any other new technologies that may come to market. We take no position in this letter regarding direct distribution of gasoline-powered cars, which have been mostly distributed through franchised dealer networks since the middle of the twentieth century. We use “direct distribution” as a shorthand to include selling vehicles directly to consumers through company-owned retail centers or online activity, and opening service centers to service vehicles.

A brief review of the history of dealer franchise laws may help explain how we got to where we are today. In the mid-twentieth century, car dealers were mostly “mom and pop” sole proprietorships. By contrast, the “Big Three” auto companies were hegemonic firms that faced relatively little domestic or foreign competition. The dealers began to complain to state legislatures that the car companies were taking advantage of them in a variety of ways. This led almost all of the states to pass dealer franchise laws intended to protect the dealers. Among other things, these laws prohibited a manufacturer from opening its own showrooms or service centers and transacting directly with customers. The dealers successfully argued that if the manufacturers were allowed to distribute directly to consumers, they could unfairly undermine their own franchised dealers.

Fast-forward to 2021. The situation is very different. First, the dealership system has grown from its “mom and pop” roots to one where enormous companies operate large dealer networks. The top 10 dealership groups alone earn over \$97 billion in annual revenue.<sup>2</sup> Second, the car manufacturer market has become far more competitive. Today, there are at least 15-20 major manufacturer groups selling cars in the U.S. This gives dealers more choices, and hence more leverage in contractual negotiations with manufacturers. Third, and perhaps most importantly, technological and market changes have led new entrants into the market—particularly companies selling EVs—to choose to distribute directly to consumers and not to use franchised dealers at all. As the Massachusetts Supreme Court has recognized, the original concerns that animated the direct distribution prohibitions—protecting a franchisee from its own franchisor—do not apply to a company that is not using franchisees.<sup>3</sup>

Not only have the original justifications for prohibiting direct distribution evaporated, but the advent of EV technology has created an urgent need to *permit* direct distribution. Virtually every significant EV start-up has taken the position that mandatory distribution only through established franchised dealers is not viable for EVs for a variety of reasons, including:<sup>4</sup>

- 1) **Dealership locations:** Dealerships are often found in out-of-the way locations. EV companies need to “bring the new technology to the consumer” in places like shopping malls and city centers.
- 2) **Inventory differences:** Large inventory is the lifeblood of traditional dealerships, but many EVs work on a build-to-order model.
- 3) **Longer sales cycles:** The franchised dealer model is based on high volume of fast-paced sales. EV buyers take longer to educate

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<sup>2</sup> <https://s3-prod.autonews.com/data-protected/032519-2019Top150DealershipGroups-032519.pdf?djoDirectDownload=true>.

<sup>3</sup> *Massachusetts State Auto Dealers Ass’n, Inc. v. Tesla Motors MA, Inc.*, 15 N.E. 3d 1152, 1157 (Mass. 2014).

<sup>4</sup> The following list is drawn from testimony given by Tesla and Rivian at administrative and legislative hearings. See <https://evannex.com/blogs/news/74602181-tesla-defends-direct-sales-model-at-ftc-talks-cites-unfair-opposition-from-gm>.

themselves on EV sales, and therefore need to work with sales people who are not working on a commission model.

- 4) **Different profit models:** Traditional dealerships earn low profit margins on new car sales, and make it up on service. EVs have a much smaller service component since they don't have service needs like oil changes or engine tune-ups. Traditional dealerships therefore lack much of an incentive to sell EVs.
- 5) **Conflict of interest.** EV sales cannibalize internal combustion sales, which are the dealers' lifeblood. Dealers therefore lack the motivation to sell EVs.
- 6) **Direct customer relationship.** Optimal EV performance requires a direct relationship between the EV manufacturer and the customer for things like over-the-air updates and vehicle performance monitoring.

To be very clear, we take no position on how a manufacturer should decide to distribute EVs, or whether any particular strategy would be better than another one—those are matters to be determined by experimentation and market competition rather than academic opinion or government fiat. Dealers may still be able to play some role in EV distribution and servicing, and some of the legacy companies have suggested they may try hybrid direct/dealer models. The important point is that there are credible reasons to believe that the EV start-ups, which know their business better than anyone else does, are correct in claiming that mandating traditional dealer distribution will significantly impair their ability to sell EVs. That, in turn, leads to a variety of negative consequences.

Most immediately, direct distribution prohibitions threaten to slow EV market penetration. This denies consumers the opportunity to take advantage of new technologies, and also flies in the face of federal and state policies prioritizing a transition to clean, renewable energy. The slower the adoption of EVs, the longer internal combustion cars stay on the road, contributing to carbon emissions. Environmental organizations have made reforming direct distribution laws a policy priority for this very reason. Further, by locking in incumbent technologies, direct distribution prohibitions threaten to limit the dynamism and growth of the U.S. EV industry, putting U.S. firms behind foreign competition.

Direct distribution prohibitions are also bad for consumer interests. The staff of the U.S. Federal Trade Commission—the leading consumer protection agency in the country—has taken the position that direct distribution bans are bad for consumers,<sup>5</sup> as have the Consumer Federation of America, Consumer Action, Consumers for Auto Reliability and Safety, and the American Antitrust Institute.<sup>6</sup> While the dealers have argued that

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<sup>5</sup> [https://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-regarding-michigan-senate-bill-268-which-would-create-limited-exception-current/150511michiganautocycle.pdf](https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-regarding-michigan-senate-bill-268-which-would-create-limited-exception-current/150511michiganautocycle.pdf) (statement by Directors of Bureaus of Economics and Competition and Office of Policy Planning).

<sup>6</sup> <https://www.autonews.com/assets/PDF/CA98362217.PDF>.

manufacturers will overcharge customers if they can sell directly to them,<sup>7</sup> the argument that adding a mandatory layer of costs between the manufacturer and the consumer will reduce consumer prices has no basis in economics. There is no credible consumer protection argument in favor of prohibiting direct distribution. Consumers should be given the choice of how they buy their cars.

Finally, direct distribution prohibitions conflict with free enterprise and first principles of regulation. Prohibiting direct distribution benefits car dealers by protecting them from competition, but that is not a legitimate basis for interfering with manufacturer and consumer freedom to decide how to buy and sell cars themselves.

The dealer protection laws were written for the mid-twentieth century. It is time for a new approach. We call on those states that still place limitations on direct sales and service by EV manufacturers to reform their laws to allow for direct distribution by any manufacturer selling EVs.

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<sup>7</sup> Daniel A. Crane, *Tesla, Dealer Franchise Laws, and the Politics of Crony Capitalism*, 101 Iowa L. Rev. 573, 594 n. 111 (2016) (collecting quotes from dealers).

<sup>8</sup> Signatories join in their individual capacities only, and their joining should not be construed as a statement about the views of their employers, clients, or any organization with which they are affiliated. No signatory has been compensated by any entity to prepare, organize, or join this letter, nor did any entity apart from the signatories have any part in its drafting or organization. In short, this letter represents our views only and was not paid for or procured by anyone else.

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